Manufacturing 2010 outlook tough

Coface, the international credit insurer, said on Tuesday, 26 January, that the manufacturing sector would remain tough in 2010, however, the steel industry was set to improve towards the end of the first quarter.

It noted that the manufacturing sector saw substantial decreases in production due to a decline in domestic and international demand in 2008 and 2009.

It also highlighted figures from Stats SA, which revealed a recovery in the sector. Manufacturing production decreased year-on-year only 4.7% in November, the smallest fall since October 2008. November factory output rose 0.7% in volume, the third successive monthly rise.

Coface pointed to high interest rates, which "affected the entities' profitability as well as their cash flows. The sector will benefit from the reduction in interest rates as well as the relatively low fuel cost component at present, as this directly affects the price of input costs," it said.

Coface said that the latest data did reflect a slowdown in terms of the contraction of this sector, but the latest production figures also indicated a move towards normality.

"The various confidence indices also confirm that this sector is turning the corner. The rebound in this sector will largely depend on the strength of the rand as well as retail spend," the credit insurer said.

It said trading conditions in 2010 would remain tough but indications are that the sector would see improved production figures and demand.

"The recovery in this sector will remain slow and January to March will most likely be slow months for the sector as the economy recovers from the festive season spend.

"Operators within this sector need to remain prudent and focus on effective cash flow management as well as on inventory control," Coface said.

South African steel producers, to a large extent, held their own in 2009 despite of a number of them reporting downsizing and other survival measures, Coface noted.

It said that South Africa had a significant backlog of infrastructural reinvestment that needed to be addressed. "Because of this, sustainability of government's Infrastructure Roll-Out Programme should last well beyond 2010.

Therefore, South African steel producers are not looking at the current economic conditions as a threat to the future of the program, with the recent drop in prices only alleviating some of the pressures associated with funding," Coface said.

It added that a further decline in the market was not expected, but current conditions should continue in the foreseeable future, with an improvement towards the end of the first quarter of 2010.

"Cashflow for many steel suppliers will remain the major issue, with the aim now being survival. The few companies with the cashflow to carry some capital expenditure for a few months may attempt to position themselves to increase their market share, if the market should turn in early 2010," the group said.

All indicators pointed towards a recovery in the steel price in 2010.

"This view is based on projected price increases in the raw materials used in the manufacturing of steel, electricity price increases, and an expected increase in demand for steel from the manufacturing sector," Coface said.

However, it added that the greatest threat to a recovery in the South African steel industry was the proposed increase of 35% per year for the next three years in the price of electricity.

"This will not only have a significant effect on the cost of producing steel, but also affect the production costs of manufacturers of fabricated steel products, and impact on the cashflow and steel consumption of the end-user, who effectively drive the whole industry," the group concluded.